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Reappraising Minority Shareholder Protection in Freezeout Mergers: Weinberger v. UOP, Inc.

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REAPPRAISING MINORITY SHAREHOLDER PROTECTION IN FREEZEOUT MERGERS: *WEINBERGER* V. *UOP, INC.*

Under Delaware corporation law, controlling shareholders may effectively "freeze out"[1] the equitable interest of the minority shareholders by the consummation of a merger in which cash is exchanged for the minority shares.[2] In some states, the exclusive

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[1] A freezeout involves "the use of majority control to consummate a statutory corporate proceeding that is intended to, and has the result of, eliminating from the corporation all of the shareholders not a part of such control . . . ." Lynch, *A Concern for the Interest of Minority Shareholders Under Modern Corporation Laws*, 3 J. CORP. L. 19, 31 (1977). The terms "squeeze-out," *see* F. O'NEAL, "SQUEEZE-OUTS" OF MINORITY SHAREHOLDERS 1 (1975), "take out," *see* Weiss, *The Law of Take Out Mergers: A Historical Perspective*, 56 N.Y.U. L. REV. 624, 625 (1981), "going private," *see* 1 M. LIPTON & E. STEINBERGER, TAKEOVERS AND FREEZEOUTS § 9.1, at 419 (1978), and "cash out," *see* Note, *Delaware Corporation Law:* Weinberger v. UOP, Inc.—*A Limitation on* Singer *Fairness Standards?*, 42 U. PITT. L. REV. 915, 917 (1981) [hereinafter cited as Note, Singer *Fairness Standards*], also are used to describe such transactions. The phrases "going private" and "cash out," however, describe particular freezeout tactics. In a going private transaction, a publicly held corporation eliminates all the public investors for the purpose of ending all public trading. *See* Note, *Fairness in Freezeout Transactions: Observations on Coping with Going Private Problems*, 69 KY. L.J. 77, 77-78 (1980-1981) [hereinafter cited as Note, *Going Private Problems*]. A cash-out merger is one in which cash serves as the consideration for the minority's equity participation. *See* Note, Singer *Fairness Standards, supra*, at 917. Although mergers are the most commonly used freezeout method, *see* Brockmeyer & Yerkes, *Two-Step Acquisitions—"Freezing Out" Minority Shareholders*, in 1 BUSINESS ACQUISITIONS § 19.202b, at 730 (J. Herz & C. Baller 2d ed. 1981), a minority shareholder's interest also may be displaced by a reverse stock split, a sale of all or substantially all assets of the corporation, dissolution, or a tender offer by the majority shareholder, *see id.* § 19.201c-.201f, at 729.

[2] DEL. CODE ANN. tit. 8, § 251(b)(4), (5) (1974 & Supp. 1982); *cf.* CAL. CORP. CODE § 1101(d) (West 1977 & Supp. 1983); N.Y. BUS. CORP. LAW § 902(a)(3) (McKinney 1963). At common law, organic changes in corporate structure, such as mergers, could be effected only through the unanimous assent of the shareholders. Voeller v. Neilston Warehouse Co., 311 U.S. 531, 535 n.6 (1941). Traditionally, the corporate charter was regarded as both a contract between the corporation and the state, and a contract among the shareholders which gave them a "vested right" in the corporation. Weiss, *supra* note 1, at 627. In recognition of the need for corporate flexibility, state legislatures began to reduce the ability of minority shareholders to dissent from fundamental changes in the corporation's structure. *Id.* at 626-57. By the early 20th century, most state corporation statutes permitted merger transactions if the corporation obtained the approval of a supermajority of the shareholders. *See* Carney, *Fundamental Corporate Changes, Minority Shareholders, and Business Purposes*, 1980 AM. B. FOUND. RESEARCH J. 69, 95. The modern trend, however, is to require only a simple majority vote. *See id.*

remedy for a shareholder who opposes a merger proposal is a statutory appraisal proceeding in which the court assesses the value of the dissenting shares.[3] Delaware and other jurisdictions have afforded greater protection to minority shareholders by providing equitable relief, such as rescission of the merger or injunction, when the majority is shown to have violated its fiduciary duty.[4] In

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Merger laws also were liberalized by cash merger statutes, which sanction the use of cash or debt as consideration for minority shares in merger transactions. *See* Weiss, *supra* note 1, at 632; *see also* CAL. CORP. CODE § 1101(e) (West 1977 & Supp. 1983) (cash may be used as consideration when controlling shareholders have greater than 90% or less than 50% of shares issued by corporation). Subsequent judicial interpretation of these statutes authorized the use of the freezeout merger. *See* Weiss, *supra* note 1, at 641. The recent enactment of short-form merger statutes represents the most radical departure from the strictures of the common law. *See* Comment, *The Short Merger Statute*, 32 U. CHI. L. REV. 596, 596-99 (1965). Under these statutes, a parent corporation may consummate a merger without shareholder approval if the target corporation is a wholly owned subsidiary or a subsidiary in which the parent owns at least a stated percentage of the corporation. *See, e.g.*, DEL. CODE ANN. tit. 8, § 253 (1974 & Supp. 1982) (90% ownership required); ILL. ANN. STAT. ch. 32, § 157.66(a) (Smith-Hurd Supp. 1983-1984) (99% ownership prerequisite); N.Y. BUS. CORP. LAW § 905(a) (McKinney 1963 & Supp. 1982-1983) (95% ownership necessary).

[3] *See, e.g.*, Deutsch v. Blue Chip Stamps, 172 Cal. Rptr. 21, 24 (Ct. App. 1981); Yanow v. Teal Indus., 178 Conn. 262, 274-75, 422 A.2d 311, 318 (1979). The appraisal statutes were enacted to provide a monetary substitute for the common-law vested rights negated by modern merger statutes. *See* Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 226 (1962). Indeed, the right of a dissenting shareholder to demand an appraisal and have his shares purchased by the corporation did not exist at common law. 6 Z. CAVITCH, BUSINESS ORGANIZATIONS § 112.01, at 112-4 (1983). The particulars of appraisal statutes vary from state to state. Lynch, *supra* note 1, at 51. Generally, the appraisal procedure is a complex one, *see* Greene, *Corporate Freeze-out Mergers: A Proposed Analysis*, 28 STAN. L. REV. 487, 504 (1976), and dissenting shareholders must strictly adhere to the statute in order to invoke the remedy, *see* 6 Z. CAVITCH, *supra*, § 112.03[1], at 112-41. Most appraisal statutes require a dissenting shareholder to object in writing to the proposed action prior to the shareholder meeting and, if the action passes, to make a written demand for the value of his shares. *See id.*

The appraisal remedy has been criticized for being excessively time consuming and costly to dissenting shareholders. Easterbrook & Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 731 (1982). The new Delaware appraisal statute, however, permits both a quasi-class action for share valuation and payment of attorney's and expert witness' fees from a fund maintained for the dissenting shareholders. DEL. CODE ANN. tit. 8, § 262(e)-(j) (1974 & Supp. 1982); *see* Rothschild, *Going Private*, Singer, *and Rule 13e-3: What are the Standards for Fiduciaries?*, in 1 CORPORATE COUNSEL'S ANNUAL—1980, at 305, 318 (J. Spires & E. Burchell eds.).

[4] *See, e.g.*, Singer v. Magnavox Co., 380 A.2d 969, 976, 980 (Del. 1977), *overruled on other grounds*, Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983); Perl v. IU Int'l Corp., 61 Hawaii 622, 640, 607 P.2d 1036, 1046 (1980); Berkowitz v. Power/Mate Corp., 135 N.J. Super. 36, 45-48, 342 A.2d 566, 571-72 (Ch. Div. 1975); *see also* W. CARY & M. EISENBERG, CASES AND MATERIALS ON CORPORATIONS 879-81 (5th ed. 1980). In a freezeout merger, the majority shareholders of a subsidiary or "target" corporation "stand on both sides of the transaction," since they control both parties to the merger. *See* Note, *The Fiduciary Duty of Majority Shareholders in Freezeout Mergers: A Suggested Approach*, 47 FORDHAM L.

an effort to enforce the majority's duty, Delaware courts have required an acquiring corporation that is challenged by shareholder action to demonstrate that the merger had a valid business purpose and was entirely fair to the minority.[5] Recently, however, in *Weinberger v. UOP, Inc.*,[6] the Supreme Court of Delaware, although reaffirming a frozen-out shareholder's right to equitable relief in the face of unfair dealing by the majority,[7] discarded the valid business purpose rule, holding that an unfair share price may be remedied only by a Delaware statutory appraisal proceeding.[8]

In *Weinberger*, a minority shareholder of UOP, Incorporated (UOP),[9] brought a class action challenging the validity of a freeze-out merger between UOP and Sigco, Incorporated, a wholly owned

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REV. 223, 223-24 (1978). By standing on both sides of the transaction, the majority can control the negotiations and unilaterally impose merger terms on the target corporation. *See id.* The superior bargaining position of the controlling corporation in a freezeout merger, however, creates a fiduciary relationship between parent and subsidiary. *See id.* at 224. The majority shareholder thus has a fiduciary obligation to execute the merger in an inherently fair manner. *See* Moore, *The "Interested" Director or Officer Transaction*, 4 DEL. J. CORP. L. 674, 676-77 (1979). Nevertheless, the existence of a fiduciary duty between controller and controlled "does not mean that the parent has to engage in any form of self-sacrifice for the benefit of the [subsidiary]." *Id.* at 677.

Professors Brudney and Chirelstein have identified three types of freezeout mergers: the two-step merger, going private, and the merger of affiliates. *See* Brudney & Chirelstein, *A Restatement of Corporate Freezeouts*, 87 YALE L.J. 1354, 1357-76 (1978). Each freezeout technique evokes a different level of fiduciary duty. *See id.* In a two-step merger, the minority shareholders are frozen out of the corporation shortly after an outside corporation acquires the controlling shares of the company through a successful tender offer. *See id.* at 1360. The fiduciary duty in the two-step merger is regarded as lower than that involved when going private or in a merger of affiliates. *See id.* at 1361. In a going private merger, the fiduciary duty of the majority is very high. *See id.* at 1365-70; *infra* note 30 and accompanying text. An affiliates merger is one between a long-standing parent and a subsidiary corporation. *See* Brudney & Chirelstein, *supra*, at 1370. Although the fiduciary duty in an affiliates merger is great, Brudney and Chirelstein argue that the social benefits derived from such a transaction militate in its favor. *See id.* at 1370-75.

[5] *See* Roland Int'l Corp. v. Najjar, 407 A.2d 1032, 1034, 1037 (Del. 1979); Singer v. Magnavox Co., 380 A.2d 969, 976, 979-80 (Del. 1977); Tanzer v. International Gen. Indus., 379 A.2d 1121, 1124-25 (Del. 1977); Sterling v. Mayflower Hotel Corp., 33 Del. Ch. 293, 93 A.2d 107, 109-10 (Del. 1952); *accord* Klurfeld v. Equity Enters., Inc., 79 App. Div. 2d 124, 134-35, 436 N.Y.S.2d 303, 309 (2d Dep't 1981) (upon merger of principal corporation with newly formed corporation owned by majority shareholders, New York applies strict scrutiny test to majority shareholders).

[6] 457 A.2d 701 (Del. 1983).

[7] *Id.* at 714.

[8] *Id.* at 703-04, 714.

[9] UOP was involved in several fields of business, including petrochemical services and products, and transportation equipment products. 457 A.2d at 704. UOP's stock was publicly traded on the New York Stock Exchange. *Id.*

subsidiary of Signal Companies, Incorporated (Signal),[10] which was the majority shareholder of UOP.[11] Although a majority of the shareholders formally approved the transaction,[12] the plaintiff alleged that the merger was not entered into for a legal business purpose, that the proxy information disseminated by UOP was misleading, and that the minority's shares were unreasonably undervalued.[13] In addition, the plaintiff contended that UOP's board of

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[10] Signal Companies, Incorporated, a technologically oriented Delaware corporation, conducted business through several wholly owned subsidiaries. Weinberger v. UOP, Inc., 426 A.2d 1333, 1335 (Del. Ch. 1981). The merger was executed through the Signal subsidiary, Sigco Incorporated. *Id.* at 1335. Signal's stock was publicly traded on the New York, Philadelphia, and Pacific Stock Exchanges. 457 A.2d at 704.

[11] 426 A.2d at 1335. In 1975, Signal obtained 50.5%, or 5,800,000 of the outstanding shares of UOP through a dual method of acquisition negotiated by both Signal and UOP. 457 A.2d at 704. Signal purchased 1,500,000 shares of unissued UOP stock at $21 per share, and acquired 4,300,000 shares from the public shareholders of UOP through a successful cash tender offer at the same price. *Id.* As controlling shareholder, Signal elected 6 of UOP's 13 directors. *Id.*

In 1978, Signal decided that the acquisition of the additional 49.5% of UOP stock not only would be a good investment for Signal, *id.* at 705, but also would resolve difficulties in managing UOP, *id.* at 708. Although Signal considered a price of up to $24 per share a reasonable acquisition price, *id.* at 705, the board of directors, at a teleconferenced meeting of the boards of both corporations, proposed the freezeout merger at a price of $21 per share. *Id.* at 707. The non-Signal directors of UOP voted that day to accept Signal's offer. *Id.* More than 2 months later, the UOP shareholders made Signal's offer effective by approving the merger at their annual meeting. *Id.* at 707-08; *see infra* note 13. Thereafter, the plaintiff brought a class action on behalf of all UOP shareholders who had not cashed in their stock on the day the merger became effective, 426 A.2d at 1335, and sought to set aside the merger or, in the alternative, an award of "equitable rescission"—an award granting former minority shareholders either money damages or stock in the surviving corporation. *Id.*

[12] 457 A.2d at 708. Pursuant to Signal's resolution, the merger would be deemed rejected if not approved by a majority of the minority shares voting at the meeting, or if "the minority shares voting in favor of the merger, when coupled with Signal's 50.5% interest . . . [did not] comprise at least two-thirds of all UOP shares." *Id.* at 707. The merger was approved at the shareholder's meeting by 51.9% of the minority shares and 76.2% of outstanding UOP shares, with only 2.2% of UOP's shares voting against the merger. *Id.* at 708.

[13] 426 A.2d at 1340-41. The plaintiff contended that the merger was consummated purely for Signal's economic benefit. *Id.* With respect to the allegedly misleading proxy information, the plaintiff made three specific charges. *Id.* at 1350. First, Weinberger contended that Signal's press releases asserting that negotiations had been conducted between Signal and UOP were inaccurate since UOP never negotiated the price. *Id.* at 1341. The only evidence of negotiation by UOP was the suggestion made by its president that some assurances be given to the employees of UOP about their future and their stock option plans. 457 A.2d at 705. Indeed, the word "negotiations," which was used in the original proxy statement, was changed to "discussions" after the Securities and Exchange Commission inquired into the nature of the negotiations. *Id.* at 708. Second, Weinberger argued that the inclusion of the fairness opinion by Lehman Brothers, an "independent" investment banking firm, in the proxy materials was misleading since Lehman Brothers allegedly was biased and had prepared the opinion in a cursory fashion. 426 A.2d at 1341. Third, the

directors breached its fiduciary duty to the minority shareholders by failing to negotiate for a greater price per share.[14] The Delaware Court of Chancery rejected the plaintiff's arguments and held that the merger had a valid business purpose and was entirely fair to the minority shareholders.[15]

On appeal, the Supreme Court of Delaware reversed.[16] Writing for a unanimous court,[17] Justice Moore noted that majority shareholders bear the ultimate burden of proving the fairness of a merger, although a plaintiff first must establish some ground for inquiring into the fairness of the transaction.[18] The court observed, however, that when an informed majority of the minority shareholders vote to approve a merger, the burden of proving the action was unfair rests on the plaintiff.[19] Nevertheless, the court concluded that since the minority in *Weinberger* had cast an uninformed vote, the ultimate burden of proof remained on UOP.[20]

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plaintiff maintained that the proxy statements were inaccurate because the Signal-affiliated board members did not vote on the merger. *Id.* at 1351. Finally, the plaintiff introduced expert financial testimony to prove that the minority's interest was worth at least $26 per share. 457 A.2d at 712. The analyst used two methods of valuation—"a comparative analysis of the premium paid over market in ten other tender offer-merger combinations, and a discounted cash flow analysis." *Id.*

[14] 426 A.2d at 1341. The president of UOP told the executive board of Signal that he thought that the proposed $20 to $21 price range was "generous." 457 A.2d at 705. After consulting with the non-Signal directors of UOP, the president suggested that the higher price would be more acceptable to UOP. *Id.* at 706. No representative of UOP suggested that a price in excess of $21 be considered. 426 A.2d at 1353. Indeed, the board of directors of UOP did not even inquire into the actual value of the minority shares, despite the fact that the corporation's books did not reflect the true value of substantial corporate assets. *Id.*

[15] 426 A.2d at 1350, 1363. The vice chancellor held that Signal's conclusion that the UOP acquisition would be a good investment constituted a valid business purpose. *Id.* at 1350. With respect to the entire fairness issue, the court found that UOP did, in fact, negotiate for a $21 price per share, *id.* at 1352, and that the price offered was fair under the standard appraisal method, *id.* at 1362. The court concluded, therefore, that UOP's proxy information and Signal's press releases were not misleading, *id.* at 1353, and that the UOP board of directors did not breach its fiduciary duty to the minority shareholders, *id.* at 1356.

[16] 457 A.2d at 703. The Delaware Supreme Court affirmed the court of chancery judgment in February 1982. *See* Deutsch, Weinberger v. UOP: *Analysis of a Dissent*, 6 CORP. L. REV. 29, 29 (1983). The 1982 opinion subsequently was withdrawn and the case was reheard en banc. 457 A.2d at 703 & n.1. For a discussion of the 1982 *Weinberger* opinion, see Deutsch, *supra*, at 29-38.

[17] Justice Moore was joined by Chief Justice Herrmann, Justices McNeilly, Quillen, and Horsey.

[18] 457 A.2d at 703. The court emphasized that particular acts of fraud, misrepresentation, or other misconduct must be alleged to state a valid cause of action. *Id.*

[19] *Id.*

[20] *Id.* The court found that the failure of Signal to disclose material information to the minority shareholders of UOP constituted a breach of the defendant's fiduciary duty to the

Turning to the issue of fairness, Justice Moore reiterated the standard rule: fairness is comprised of fair dealing and fair price.[21] Examining the events leading up to the vote, the court found that the perfunctory negotiations conducted by UOP, the failure of Signal's board to disclose material information regarding the value of the shares, and the effect of the unusual time constraints that Signal imposed upon UOP and its financial advisors, contradicted the requisites of fair dealing.[22] With respect to fair price, Justice Moore declared that the traditional "Delaware block" approach, by which a court considers only the assets, market price, and earnings of a corporation as elements of valuation, was archaic.[23] Thus, the Supreme Court of Delaware held that a less restrictive method of valuation was required under the recently amended appraisal statute, which obligates Delaware courts to consider "all relevant factors" when determining the fair value of shares.[24] This expanded appraisal remedy, the court determined, affords adequate protection to dissenting shareholder's interests unless unfair dealing warrants equitable relief.[25] Finally, the court abrogated the business purpose requirement, reasoning that the traditional fairness proceeding and the transformed appraisal remedy obviated the need for any protection which possibly could be afforded by the business purpose rule.[26]

The *Weinberger* court's reliance on the "liberalized" appraisal remedy in freezeout mergers appears to balance properly the competing state interests in minority shareholder protection and corporate flexibility. This Comment will examine the business purpose and entire fairness tests in light of *Weinberger* and the current Delaware appraisal statute,[27] and will suggest that the minimum value to be accorded frozen-out shares be determined by

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plaintiffs. *Id.*

[21] *Id.* at 711.

[22] *Id.* at 711-12; *see supra* note 14.

[23] 457 A.2d at 712; *see infra* note 72 and accompanying text.

[24] *Id.* at 713-14. The statute provides, in pertinent part:

> [T]he Court shall appraise the shares, determining their fair value exclusive of any element of value arising from the accomplishment or expectation of the merger. . . . In determining such fair value, the Court shall take into account all relevant factors.

DEL. CODE ANN. tit. 8, § 262(h) (1974 & Supp. 1982).

[25] 457 A.2d at 714.

[26] *Id.* at 715; *see infra* notes 33-36 and accompanying text.

[27] *See infra* notes 30-68 and accompanying text.

reference to a third-party sale value.[28]

DEMISE OF THE *Singer* BUSINESS PURPOSE RULE

It is submitted that *Weinberger* is a retreat from the overzealous protection afforded minority shareholders in *Singer v. Magnavox Co.*,[29] in which the Supreme Court of Delaware held that freezeout mergers are invalid absent a legitimate business purpose and a showing of entire fairness.[30] *Singer* is regarded as a response to the corporate practice of going public during the inflated stock market conditions of the 1960's, and then freezing out the recently solicited shareholders at low share values in the 1970's bear market.[31] Although the concept of entire fairness had been

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[28] *See infra* notes 77-92 and accompanying text.

[29] 380 A.2d 969 (Del. 1977), *overruled in part,* Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

[30] *Id.* at 980. *Singer* involved a two-step merger, in which North American Philips Corporation attempted to merge with Magnavox Company (Magnavox) shortly after acquiring an 84.1% interest in Magnavox through a successful tender offer. *Id.* at 971. Although the value of Magnavox stock was at all relevant times in excess of $10 per share, both the tender offer and cash-out prices were $9 per share. *Id.* at 971-72. The plaintiffs brought a class action to declare the merger a nullity, alleging that the merger lacked a valid business purpose and that the defendants breached their fiduciary duty to the minority shareholders by accepting an inadequately low price. *Id.* The Delaware Court of Chancery dismissed the complaint on the ground that the plaintiffs' sole remedy was a statutory appraisal proceeding. *Id.* On appeal, the Supreme Court of Delaware reversed, holding that compliance with the merger statute did not relieve the defendants of their fiduciary duty to the minority shareholders. *Id.* at 975. The court further held that this fiduciary duty not only required such mergers to be entirely fair to the minority shareholders, *id.* at 976, but also prohibited the consummation of a merger transacted for the exclusive purpose of freezing out the minority shareholders, *id.* at 980.

[31] *See* Note, Singer v. Magnavox *and Cash Take-Out Mergers,* 64 VA. L. REV. 1101, 1112 (1978). In addition to the advantage to be gained from depressed market prices, corporations that go private also will be able to avoid compliance with SEC regulations in the future. Comment, *An Appraisal of Authority for the Fairness Standard Contained in the SEC's Proposed "Going-Private" Regulations,* 28 EMORY L.J. 111, 114 (1979). Going-private transactions were considered an abuse of the public, *see* Note, *supra,* at 1112, since the minority shareholders' interest in the corporation was terminable at the will of the majority shareholders, *see* Note, *Going Private Problems, supra* note 1, at 78 n.5. Indeed, the problem had reached such proportions that the commissioner of the SEC expressed concern over the public shareholder hostility engendered by such transactions. Address by Commissioner Sommer, Law Advisory Council Lecture, Notre Dame Law School (Nov. 1974), *reprinted in* SEC. REG. & L. REP. (BNA) No. 278, at D-1 (1974); *see* Note, *supra,* at 1112. Nevertheless, in Santa Fe Indus. v. Green, 430 U.S. 462 (1977), the Supreme Court noted that "[t]here may well be a need for uniform federal fiduciary standards to govern [such] mergers," but refused to extend federal jurisdiction under rule 10b-5 to mergers in the absence of congressional intent to regulate mere corporate mismanagement, *id.* at 479-80. It has been suggested that *Singer* may have been an attempt by the Delaware Supreme Court to avoid federal intervention in the traditional state regulation of mergers. *See* Chazen, *"UOP"*

established in Delaware long before *Singer*,[32] the requirement that mergers be effected for a legitimate business purpose was novel in Delaware.[33] Unfortunately, what will pass muster as a valid business purpose has never adequately been articulated.[34] A merger transacted for the exclusive purpose of freezing out minority shareholders was invalid under the *Singer* rule.[35] Post-*Singer* decisions, however, have indicated that the business purpose requirement could be satisfied if the merger advanced the interests of either the acquiring or the acquired corporation.[36] Since few mergers would be pursued that did not advance the interests of either corpora-

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Shows Delaware Merger Laws Still Confusing, Legal Times, Mar. 7, 1983, at 15, col. 1; Note, *supra*, at 1112.

[32] *See infra* notes 51-52 and accompanying text.

[33] *See* Terrell & Ranney-Marinelli, *What Constitutes a Valid Purpose for a Merger?*, 51 TEMP. L.Q. 852, 852 (1978). The business purpose test emerged in the 1970's as a vehicle for protecting minority shareholders' equity participation in corporate matters. *See, e.g.*, Bryan v. Brock & Blevins Co., 490 F.2d 563, 570-71 (5th Cir.) (valid business test required under Georgia corporation law), *cert. denied*, 419 U.S. 844 (1974). Prior to *Singer*, Delaware courts had granted equitable relief only when fraud or illegality was demonstrated. *See, e.g.*, Stauffer v. Standard Brands Inc., 187 A.2d 78, 80 (Del. 1962) (refusing to set aside merger of parent and subsidiary absent fraud or illegality); David J. Greene & Co. v. Schenley Indus., 281 A.2d 30, 35 (Del. Ch. 1971) (minority shareholder may be eliminated by corporate reorganization absent gross unfairness). However, the *Stauffer* court observed that since the purpose of the short form merger statute is to permit a parent corporation to terminate the minority shareholders' equity participation, it was unlikely that any merger effected in accordance with the statute would be deemed fraudulent. 187 A.2d at 80.

[34] *See* Greene, *supra* note 3, at 500; Terrell & Ranney-Marinelli, *supra* note 33, at 881.

[35] *See Singer*, 380 A.2d at 980. The *Singer* court unequivocally stated that "a § 251 merger, made for the sole purpose of freezing out minority stockholders, is an abuse of the corporate process." *Id.* One commentator has concluded that "any purpose for the merger other than eliminating the minority will suffice." Note, *supra* note 31, at 1101. In Roland Int'l Corp. v. Najjar, 407 A.2d 1032 (Del. 1979), *overruled in part*, Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983), the Delaware Supreme Court rejected the contention that the Delaware short-form merger statute created a presumption of a legitimate business purpose for such mergers. 407 A.2d at 1037. Indeed, the *Roland* court found that the parent corporation had masterminded the going-private merger exclusively for the purpose of eliminating the public shareholders. *Id.*

[36] Tanzer v. International Gen. Indus., 379 A.2d 1121, 1124-25 (Del. 1977), *overruled in part*, Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983); Young v. Valhi, Inc., 382 A.2d 1372, 1376 (Del. Ch. 1978). The *Singer* court had expressly left unresolved the question of whether the interests of the subsidiary corporation must be served to satisfy the business purpose rule. *Singer*, 380 A.2d at 980 n.11. The question was answered in the negative by the *Tanzer* court, which stated that a parent corporation's interest in eliminating its long term debt financing was a bona fide reason for acquiring exclusive ownership of a subsidiary. *Tanzer*, 379 A.2d at 1124-25. Courts also have found a valid business purpose present when a parent corporation acts to avoid potential insolvency, *see* Polin v. Conductron Corp., 552 F.2d 797, 815-16 (8th Cir.), *cert. denied*, 434 U.S. 857 (1977) (applying Delaware law), and to reduce operating costs, *see* Tanzer Economic Assocs. v. Universal Food Specialties, Inc., 87 Misc. 2d 167, 182, 383 N.Y.S.2d 472, 483 (Sup. Ct. N.Y. County 1976).

tion, this broad interpretation has rendered the rule illusory.[37] In recognition of the limited protection afforded by such a construction of the rule, the Delaware Court of Chancery in *Young v. Valhi, Inc.*,[38] implied that a corporation could not satisfy the business purpose test if a less restrictive alternative was available to achieve the stated corporate purpose.[39] Apparently, no other courts have embraced such a narrow interpretation of the business purpose rule.[40]

Apart from the uncertainties resulting from inconsistent judicial interpretation of the rule, it is submitted that the business purpose test is unsound because it purports to protect the *form* of a shareholder's investment rather than the *value* of the shares.[41] Judicial concern with the shareholder's right to participate in the management of a corporation is a needless reversion to the repudiated common-law notion that shareholders possess a property right in the corporation.[42] A modern shareholder is more concerned with

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[37] *See* Easterbrook & Fischel, *supra* note 3, at 725; Borden, *Delaware Court Writes a Fresh Script For New Going Private Performances*, N.Y.L.J., June 6, 1983, at 29, col. 1. Professors Easterbrook and Fischel have commented that the business purpose test affords minority shareholders less protection than general fiduciary principles which mandate that *none* of the shareholders be injured by the transaction. *See* Easterbrook & Fischel, *supra* note 3, at 725.

[38] 382 A.2d 1372 (Del. Ch. 1978).

[39] *See id.* at 1377 (dictum); McBride, *Delaware Corporation Law: Judicial Scrutiny of Mergers—the Aftermath of* Singer v. The Magnavox Company, 33 BUS. LAW. 2231, 2244 (1978). In *Young*, the Delaware Court of Chancery noted that the majority's desire to reduce its taxes could be accomplished without freezing out minority shareholders by means of "other corporate acquisitions." 382 A.2d 1372, 1377 (Del. Ch. 1978). This less restrictive alternative theory was "a striking deviation from the Delaware courts' customary reluctance to second-guess corporate managers' business judgments." *See* Weiss, *supra* note 1, at 669 n.291.

[40] *See* Comment, Young v. Valhi, Inc.: *Extended Protection to Minority Shareholders in Freeze-out Mergers*, 12 J. MAR. J. PRAC. & PROC. 683, 704-06 (1979). The Indiana Supreme Court analogized a freezeout merger transacted without a valid business purpose to a voluntary dissolution of the corporation, and defined a valid business purpose as one "intended to advance a corporate interest." Gabhart v. Gabhart, 267 Ind. 370, 388, 370 N.E.2d 345, 355-56 (1977). The New York judicial interpretation of the business purpose rule comports with the *Singer* view. *See* Klurfeld v. Equity Enters., Inc., 79 App. Div. 2d 124, 135, 436 N.Y.S.2d 303, 309 (2d Dep't 1981); Alpert v. 28 William St. Corp., N.Y.L.J., Mar. 10, 1983, at 11, col. 5 (Sup. Ct. N.Y. County), *aff'd mem.*, 97 App. Div. 2d 681, 468 N.Y.S.2d 289 (1st Dep't 1983). New York courts, however, treat business purpose simply as an element of fairness. *See Klurfeld*, 79 App. Div. 2d at 135, 436 N.Y.S.2d at 309; *Alpert*, N.Y.L.J., Mar. 10, 1983, at 11, col. 6.

[41] *See* Singer v. Magnavox Co., 380 A.2d 969, 977 (Del. 1977), *overruled in part*, Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

[42] *See* 1 M. LIPTON & E. STEINBERGER, *supra* note 1, § 9.3.3.1, at 444. Although the *Singer* court recognized the obsolescence of the common-law notion that a shareholder had

maximizing the return on an investment than with retaining its form.[43] Moreover, the need for shareholder protection must be balanced with the strong public policy favoring corporate flexibility and growth.[44] Granting injunctive relief when a valid business purpose has not been demonstrated promotes neither policy interest and, in fact, fosters litigation to a greater degree than the more restrictive test of fiduciary fairness.[45] It is submitted that the chilling effect of the business purpose rule on corporations attempting to consummate a value-enhancing merger is damaging both to corporate growth and to shareholder interests.[46]

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vested rights in the corporation, 380 A.2d 969, 978 (Del. 1977); *see supra* note 2, the court nevertheless posited that fiduciary principles mandate that frozen-out shareholders be accorded a legally protected right to their stockholdings, 380 A.2d at 977. The *Singer* interpretation of the majority's fiduciary duty, however, is related to the vested rights theory in that both are based on the minority shareholder's right to maintain the form of his investment. *See* Note, *Going Private Problems, supra* note 1, at 99. It would appear, therefore, that the business purpose test must yield to the same countervailing policy interest in corporate flexibility that replaced the vested rights theory. *See* E. FOLK, THE DELAWARE GENERAL CORPORATION LAW 331-32 (1972); *infra* note 45 and accompanying text.

[43] *See* Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 NW. U.L. REV. 913, 925 (1982); Note, *Going Private Problems, supra* note 1, at 99-100.

[44] *See* Weiss, *supra* note 1, at 629.

[45] *See* Borden, *supra* note 37, at 29, col. 1; Note, Singer *Fairness Standards, supra* note 1, at 937; Note, *Freezeout Merger Regulation: An SEC Rule Joins State Efforts*, 37 WASH. & LEE L. REV. 964, 969-70 (1980). After *Singer*, one commentator observed that any Delaware freezeout merger is subject to judicial scrutiny "[b]ecause the corporate majority has the burden under *Singer* of demonstrating business purpose . . . , [and] the dissenting shareholders apparently need only make allegations of impropriety to activate judicial scrutiny of the merger." Note, *supra*, at 969-70. Indeed, Justice Quillen, vigorously dissenting in Roland Int'l Corp. v. Najjar, 407 A.2d 1032, 1037 (Del. 1979) (Quillen, J., dissenting), noted the absurdity of permitting a plaintiff to obtain a judicial valuation of share price when he simply alleges an improper business purpose. *Id.* at 1039. Justice Quillen stated:

> [T]he plaintiff comes to Court more than five months after the required notice to the corporation under the statutorily established appraisal procedures and says he wants more money for his shares and the privilege of subjecting the defendants to a separate class action. He does not specifically allege or even argue to any precision why the statutory appraisal procedure is inadequate in this case. In my opinion, he has failed to state a claim upon which equitable relief can be granted . . . .

Id. at 1039-40 (footnote omitted).

It is suggested that the business purpose test and its corresponding threat of equitable intervention invite more litigation than both the statutory appraisal remedy and the *Weinberger* fairness proceeding. Under *Weinberger*, a plaintiff must "allege specific acts of fraud, misrepresentation, or other items of misconduct to demonstrate the unfairness of the merger . . . ." 457 A.2d at 703. Moreover, the statutory appraisal proceeding is unavailable to any stockholder who consents to a merger or fails to comply with rigid filing requirements. *See, e.g.*, DEL. CODE ANN. tit. 8, § 262(a), (d) (Supp. 1982); N.Y. BUS. CORP. LAW § 623(a)-(c), (f)-(h) (McKinney Supp. 1982).

[46] Fischel, *supra* note 43, at 928 & n.82. Arguably, the business purpose rule enhances a

The demise of the business purpose rule, as the *Weinberger* court observed, does not leave minority shareholders unprotected.[47] Inquiry into the business purpose for a transaction does not protect a dissenting shareholder's interest in the value of his investment, nor does it shield him from the effects of self-dealing or fraud.[48] The statutory appraisal proceeding and the fairness inquiry, however, are designed, respectively, to ensure that the dissenting shareholder receives fair value and to protect against fiduciary misconduct.[49] It is submitted, therefore, that the *Weinberger* court correctly declined to apply the business purpose rule in freezeout mergers.[50] It is suggested that other jurisdictions adopt the analysis employed in *Weinberger* when confronted with a business purpose argument.

ENTIRE FAIRNESS UNDER *Weinberger*

The concept of entire fairness, which embraces both fair dealing and fair price, was introduced in *Sterling v. Mayflower Hotel Corp.*,[51] and was applied to freezeout mergers in *Singer v.*

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minority shareholder's bargaining position, since the possibility of litigation looms over the controlling shareholders. *See id.* Unfortunately, minority shareholders may abuse this greater bargaining power by demanding "extortionate prices," Note, *supra* note 31, at 1110, and delaying the consummation of the merger, *see* Note, *supra* note 45, at 970. Because freezeout mergers are often designed to take advantage of economies of scale and to remove impediments to corporate development, *see, e.g.*, Weinberger v. UOP, Inc., 457 A.2d 701, 708 (Del. 1983), the chilling effect of the business purpose rule could impinge upon value-enhancing transactions, *see* Fischel, *supra* note 43, at 928.

[47] *See infra* note 56 and accompanying text.

[48] *See* Note, *Assuring Fairness in Corporate Mergers: Recent State Trends*, 35 WASH. & LEE L. REV. 927, 946-47 (1978). It has been argued that the business purpose test emerged as a device to circumvent complex valuation issues, Weiss, *supra* note 1, at 670, and often distracts courts from the larger issue of entire fairness, *see* Brudney & Chirelstein, *supra* note 4, at 1375; Note, *supra*, at 946. Indeed, it appears that Delaware courts have couched determinations of fairness in business purpose rhetoric. Weiss, *supra* note 1, at 670 & nn.297-98 (citing Young v. Valhi, Inc., 382 A.2d 1372 (Del. Ch. 1978), and Weinberger v. UOP, Inc., 426 A.2d 1333 (Del. Ch. 1981), *rev'd*, 457 A.2d 701 (Del. 1983)).

[49] *See infra* note 60.

[50] *See* Weiss, *The Law of Take Out Mergers:* Weinberger v. UOP, Inc. *Ushers In Phase Six*, 4 CARDOZO L. REV. 245, 249 (1983); *cf.* 1 M. LIPTON & E. STEINBERGER, *supra* note 1, § 9.6, at 485 ("in theory [no business purpose] should be necessary"); Brudney & Chirelstein, *supra* note 4, at 1375 (asserting that allegation of business purpose should be unnecessary); Note, *supra* note 4, at 241 (business purpose test is "confusing and unnecessary and should be abolished").

[51] 33 Del. Ch. 293, 93 A.2d 107 (1952). *Sterling* involved a merger of the Hilton Hotel Corporation and its subsidiary, the Mayflower Hotel Corporation. *Id.* at 296, 93 A.2d at 109. Pursuant to the terms of the merger agreement, the minority shareholders of the subsidiary exchanged their shares for an equal number of shares in the parent. *Id.* at 296, 93 A.2d at

Magnavox Co.[52] Resort to the entire fairness doctrine to examine the propriety of freezeouts is based on the assumption that judicial review can serve as a substitute for the arm's-length negotiation presumed absent in interested director transactions.[53] While the fairness test requires a balancing of fair dealing and fair price,[54] *Weinberger* indicates that the fair price/appraisal proceeding is the predominant remedy.[55] Thus, this Comment will examine fair dealing and fair price separately.

Fair Dealing

Weinberger affords equitable relief to dissenting shareholders only to remedy unfair dealing.[56] A plaintiff initially must offer some evidence of unfair dealing as a prerequisite to maintaining

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108, 109. Although a freezeout merger was not involved, the transaction constituted an interested merger since the parent corporation stood on both sides of the deal. *Id.* at 298, 93 A.2d at 110; *see* Moore, *supra* note 4, at 674. The *Sterling* court held that majority shareholders who are "interested" in a merger owe a fiduciary duty to the minority and must prove the entire fairness of the merger. 33 Del. Ch. at 298, 93 A.2d at 110. The court, however, did not define the parameters of the entire fairness test. *See* Note, *supra* note 4, at 230.

In David J. Greene & Co. v. Schenley Indus., 281 A.2d 30 (Del. Ch. 1971), the Delaware Court of Chancery held that an inquiry into the entire fairness of a freezeout merger will not be made when the plaintiff alleges only an unfair price because the statutory appraisal proceeding provides an adequate remedy. *Id.* at 35-36. Interestingly, the *Weinberger* court has adopted the same approach. *See* Weinberger v. UOP, Inc., 457 A.2d 701, 715 (Del. 1983).

[52] 380 A.2d 969, 979 (Del. 1977), *overruled in part*, Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

[53] *See* Nathan & Shapiro, *Legal Standard of Fairness of Merger Terms Under Delaware Law*, 2 DEL. J. CORP. L. 44, 46 (1977). Under the business judgment rule, "[t]he acts of directors are presumptively acts taken in good faith and inspired for the best interests of the corporation, and a minority stockholder who challenges their *bona fides* of purpose has the burden of proof." Warshaw v. Calhoun, 43 Del. Ch. 148, 221 A.2d 487, 493 (1966) (citation omitted). Courts applying the rule, therefore, refuse to question the business judgment of a director in the absence of fraud. *See* Nathan & Shapiro, *supra*, at 45. When controlling shareholders or directors stand on both sides of a transaction, however, the burden is on the interested parties to demonstrate that the transaction was entirely fair. *See id.* at 45-46.

[54] *Weinberger*, 457 A.2d at 711. The *Weinberger* court observed that "[t]he test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness." *Id.*

[55] *See id.* at 714; Kramer, *Minority Shareholders Hit by Recent Delaware Case*, N.Y.L.J., June 6, 1983, at 31, col. 3.

[56] *See* 457 A.2d at 714. The *Weinberger* court granted the chancellor power "to fashion any form of equitable and monetary relief as may be appropriate" to remedy unfair dealing. *Id.* The *Weinberger* decision expressly provides for rescissory damages as appropriate equitable relief and permits rescission of the merger itself when fraud or self-dealing is present. 457 A.2d at 714.

such an action.[57] The *Weinberger* court observed that "fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross and palpable overreaching" constitute unfair dealing.[58] Nevertheless, although some indications of unfairness may be present, they may be outweighed by an equitable price.[59] In short, the *Weinberger* analysis permits equitable intervention only when the minority shareholder is significantly disadvantaged.[60] By limiting equitable relief to egregious circumstances, this approach, it is suggested, will encourage shareholders to utilize the appraisal proceeding to recoup the value of their investment, and diminish the threat to corporate flexibility posed by the uncertain availability of equitable relief.[61]

The *Weinberger* court observed that an independent negotiating committee,[62] absent in the freezeout, could have approximated arm's-length negotiation,[63] and provided "strong evidence" of fair dealing.[64] In an attempt to provide additional guidelines for ascer-

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[57] *Weinberger*, 457 A.2d at 703.

[58] *Id.* at 714; *see* Klimpl, Stein & Hayworth, *Merger Case Will Impact on Minority Shareholder*, N.Y.L.J., June 6, 1983, at 38, col. 3.

[59] 457 A.2d at 711 ("price may be the preponderant consideration outweighing other features of the merger").

[60] It is submitted that equitable relief is necessary to protect minority shareholders only in circumstances that constitute unfair dealing. Shareholders who are not victims of overreaching, self-dealing, or nondisclosure have the ability to perfect their appraisal rights. Equitable relief under such circumstances must, then, be considered superfluous and an impingement on corporate autonomy. Moreover, since appraisal statutes typically require minority shareholders to notify the corporation of their intent to dissent prior to a vote on a proposed long-form merger, *see, e.g.*, DEL. CODE ANN. tit. 8, § 262(d)(1) (Supp. 1982); N.Y. BUS. CORP. LAW § 623(a) (McKinney Supp. 1982), restricting minority shareholders to the remedy of appraisal will encourage dissenting shareholders to manifest their dissatisfaction before the consummation of the merger.

[61] *Cf.* Fischel, *supra* note 43, at 928 (asserting that the effect of *Singer* was to allow minority shareholders to "blackmail" the majority).

[62] 457 A.2d at 709 n.7.

[63] *Id.*; *see* Nathan & Shapiro, *supra* note 53, at 47 & n.9.

[64] 457 A.2d at 709 n.7 (dictum). The *Weinberger* court stated:

> Although perfection is not possible, or expected, the result here could have been entirely different if UOP had appointed an independent negotiating committee of its outside directors to deal with Signal at arm's length. Since fairness in this context can be equated to conduct by a theoretical, wholly independent, board of directors acting upon the matter before them, it is unfortunate that this course apparently was neither considered nor pursued. Particularly in a parent-subsidiary context, a showing that the action taken was as though each of the contending parties had in fact exerted its bargaining power against the other at arm's length is strong evidence that the transaction meets the test of fairness.

Id. (citations omitted). Prior to *Weinberger*, commentators had noted that negotiations conducted by an independent committee obviated the need for an entire fairness inquiry since

taining whether fair dealing is present, it has been suggested that a fairness opinion rendered by an independent banking firm prior to the dissemination of proxy materials is evidence of both fair dealing and fair price.[65] Formal approval of a merger by a majority of the minority shareholders has also been proposed as an indication of fairness.[66] At least one commentator, however, maintains that minority shareholder approval is not a true substitute for arm's-length negotiation since the transaction involved is often a "take it or leave it proposition."[67] Thus, by requiring the plaintiff to prove the unfairness of a merger in the face of a majority of the minority's approval, the *Weinberger* court apparently has given undue weight to the vote of minority shareholders. It is suggested that the minority shareholder vote should be considered only as a factor in the fair dealing analysis, and not as a circumstance triggering a shift in the burden of proof to the dissenting shareholder.[68]

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such negotiations could be reviewed adequately within the framework of the business judgment rule. *See* Chazen, *Fairness from a Financial Point of View in Acquisitions of Public Companies: Is "Third-Party Sale Value" the Appropriate Standard?*, 36 BUS. LAW. 1439, 1440-41 (1981); Nathan & Shapiro, *supra* note 53, at 47; *see also* Harriman v. E.I. Dupont de Nemours & Co., 411 F. Supp. 133, 142 (D. Del. 1975); Puma v. Marriott, 283 A.2d 693, 696 (Del. Ch. 1971). Lipton and Steinberger have suggested that negotiations be opened not only to an independent negotiating committee, but to "sophisticated holders of a significant part of the public interest in the corporation" as well. 1 M. LIPTON & E. STEINBERGER, *supra* note 1, § 9.6, at 485.

Although the presence of an independent negotiating committee generally is recognized as an element of fair dealing, it is submitted that the *Weinberger* court may have exaggerated its significance. In actual practice, commentators have noted that an independent negotiating committee often is a more vigorous advocate for the interests of the majority shareholders than those of the minority. Kramer, *supra* note 55, at 34, col. 1; Weiss, *supra* note 50, at 255.

[65] *See* 1 M. LIPTON & E. STEINBERGER, *supra* note 1, § 9.6, at 485. Corporations frequently request their investment banker to update the fairness opinion to reflect any changes that may have occurred in the company's financial status during the interval between the approval of the initial opinion rendered at the time of the merger and the subsequent dissemination of proxy materials. Chazen, *supra* note 64, at 1463. The *Weinberger* court, however, discounted the fairness opinion in light of the cursory manner in which it was prepared. 457 A.2d at 712; *see* Chazen, *supra* note 31, at 19, col. 2. Professor Weiss has suggested that "[i]f reliance is to be placed on an investment banker's opinion, that opinion should be framed in terms of 'adequacy' or 'inadequacy,' not 'fairness' or 'reasonableness.'" Weiss, *supra* note 50, at 256.

[66] *See, e.g.*, Chazen, *supra* note 64, at 1476; Note, *supra* note 4, at 236 n.98; Note, *supra* note 48, at 937.

[67] Chazen, *supra* note 64, at 1475; *accord* Weiss, *supra* note 1, at 677; Note, *supra* note 4, at 236 n.98.

[68] *See supra* note 66 and accompanying text.

Fair Price/Appraisal

Determinations of the value of a dissenting shareholder's stock in fairness hearings traditionally have been based on statutory appraisal.[69] Most courts have adopted the "Delaware block" approach, a method of valuation in which a corporation's assets, market price, and earnings are assigned a separate weight of percentage value.[70] Stock market price, however, frequently is given primary consideration under the Delaware block method.[71] Indeed, a prior Delaware appraisal statute precluded shareholders from invoking the appraisal remedy if the market value of their shares was readily ascertainable on a national stock exchange.[72] Today, however, it has become common practice for acquiring corporations to offer premiums of up to 50% more than the market price of the stock.[73] Clearly, the Delaware block method, as noted in *Weinberger*, does not provide a fair appraisal of share value, and is, therefore, "outmoded."[74]

The use of the Delaware block approach in fairness proceedings has been subject to pervasive criticism.[75] Arguably, fiduciary

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[69] Weiss, *supra* note 1, at 671; *see, e.g.*, Klurfeld v. Equity Enters., Inc., 79 App. Div. 2d 124, 135, 436 N.Y.S.2d 303, 310 (2d Dep't 1981).

[70] *See* Lynch v. Vickers Energy Corp., 429 A.2d 497, 499 (Del. 1981); Easterbrook & Fischel, *supra* note 3, at 732; Hertz, *Corporate Action*, in 1 BUSINESS ACQUISITIONS § 6.302b, at 228-29 (J. Herz & C. Baller 2d ed. 1981); Weiss, *supra* note 1, at 672. Earnings value represents the earning potential of the acquired company as an ongoing business; net asset value is an estimate of the assets of the acquired company upon liquidation. *See* Nathan & Shapiro, *supra* note 53, at 52, 56. Under the Delaware block method, "all factors relevant to a determination of fair price in a particular situation [are] examined and given appropriate weight." *Id.* at 49; *see* Borden, *supra* note 37, at 29, col. 3.

[71] *See* Hertz, *supra* note 70, § 6.302, at 227; Nathan & Shapiro, *supra* note 53, at 51-52. *But see* L. SOLOMON, R. STEVENS & D. SCHWARTZ, CORPORATIONS LAW AND POLICY 953 (1982) ("asset value and earnings value usually receive the greatest weight"). In the case of corporations engaged primarily in real estate for which no readily ascertainable market value exists, net asset value will be accorded the greatest weight. *See* Hertz, *supra* note 70, § 6.302a-b, at 228-29.

[72] *See* DEL. CODE ANN. tit. 8, § 262(k) (1975) (current version at DEL. CODE ANN. tit. 8, § 262(k) (1983)); L. SOLOMON, R. STEVENS & D. SCHWARTZ, *supra* note 71, at 953-54 (statute reflects theory that "the ability to sell on the open market provides an adequate means of escape for the dissenting shareholder").

[73] Chazen, *supra* note 64, at 1450-51. Prior to the tender offer in *Weinberger*, the common stock of UOP had been traded at less than $14 per share. 457 A.2d at 704.

[74] 457 A.2d at 713; *see* L. SOLOMON, R. STEVENS & D. SCHWARTZ, *supra* note 71, at 953-54; Chazen, *supra* note 64, at 1451; Borden, *supra* note 37, at 30, col. 1. *But see* Easterbrook & Fischel, *supra* note 3, at 732 ("no evidence that shareholders are undercompensated in appraisal proceedings").

[75] *See* Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297, 312-13 (1974); Chazen, *supra* note 64, at 1451; Note, *Going Private*

principles mandate that minority stockholders share in the "synergistic" benefits of a merger—that is, the advantages that accrue to the acquiring corporation through consummation of the merger.[76] Some commentators assert that since the purpose of a fairness proceeding is to approximate arm's-length negotiation, a third-party sale value should be used to evaluate the price of minority shares.[77] Discounted cash flow is often considered by modern financial analysts to be an important factor in appraising the third-party sale value of a corporation.[78] The Delaware block approach, however, does not provide any means of evaluating either discounted cash flow or the synergistic effects of a merger.[79]

Delaware and New York recently amended their appraisal statutes to include concepts of fairness in recognition of the need

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Problems, supra note 1, at 116.

[76] Brudney & Chirelstein, *supra* note 4, at 1371-74; *see* 1 M. LIPTON & E. STEINBERGER, *supra* note 1, § 9.6, at 486-88. Professors Brudney and Chirelstein were the first commentators to propose gain-sharing principles in parent-subsidiary mergers. *See* Brudney & Chirelstein, *supra* note 75, at 297. Observing that true arm's-length bargaining was impossible in parent-subsidiary mergers, *id.* at 317-19, Brudney and Chirelstein concluded that the parent's fiduciary duty to its minority shareholders requires receipt by all shareholders of an equal return on their investment, *id.* at 322. They caution, however, that minority shareholders should be given equal, though not necessarily identical, treatment to that given the majority shareholders. *See* Brudney & Chirelstein, *supra* note 4, at 1358. Since freezeout mergers frequently produce a new corporation with a greater value than either company would have enjoyed as a separate entity, *see id.* at 1371, Brudney & Chirelstein argue that a pro rata share of this increase in value should be distributed to minority shareholders. *See* Brudney & Chirelstein, *supra* note 75, at 322. In Mills v. Electric Auto-Lite Co., 552 F.2d 1239 (7th Cir.), *cert. denied*, 434 U.S. 922 (1977), the Seventh Circuit expressly applied a gain-sharing test to determine fair share value in a freezeout merger, *id.* at 1248. The Delaware Court of Chancery, however, held that the synergistic effect of a freezeout merger could not be considered in either a fairness or a statutory appraisal proceeding. Tanzer v. International Gen. Indus., 402 A.2d 382, 394-95 (Del. Ch. 1979). For an extensive criticism of gain sharing in freezeout mergers and other corporate control transactions, see Easterbrook & Fischel, *supra* note 3, at 703-15, 726-31.

[77] *See* 1 M. LIPTON & E. STEINBERGER, *supra* note 1, § 1.2.1, at 43 (Supp. 1979); Chazen, *supra* note 64, at 1450-51. The third-party value standard requires that a fair cash-out price be, at minimum, "the price per share that could have been obtained if the acquired company had been sold, as an entirety, to another purchaser . . . ." Chazen, *supra* note 64, at 1450 (footnote omitted). Chazen acknowledges that third-party sale value in parent-subsidiary mergers actually may be a competitive rather than an arm's-length price, *id.* at 1470-71, but advocates the third-party sale value standard as a "safe harbor" for establishing a fair cash-out price, *id.* at 1477.

[78] *See* ACQUISITION AND MERGER NEGOTIATING STRATEGY 109-12 (M. Strage ed. 1971).

[79] *See* Weinberger v. UOP, Inc., 426 A.2d 1333, 1360-61 (Del. Ch. 1981) (the discounted cash flow method does not "correspond with either logic or the existing law"), *rev'd*, 457 A.2d 701 (Del. 1983); Tanzer v. International Gen. Indus., 402 A.2d 382, 394-95 (Del. Ch. 1979) (synergistic effects could not be considered under the appraisal statute).

for reform in appraisal proceedings.[80] New York's amended statute, which is the more progressive of the two, permits courts to employ any valuation methods utilized by the financial community and to consider "all other relevant factors."[81] As the legislative history of the statute makes clear, the value of the corporation as a whole may be used to ascertain the fair value of its shares.[82] Although the Delaware statute also allows courts to employ an "all relevant factors" analysis, the statute expressly excludes "any element of value arising from the accomplishment or expectation of the merger."[83] Nevertheless, the *Weinberger* court, apparently influenced by the broad sweep of the New York statute, refused to construe strictly the Delaware statute.[84] The *Weinberger* opinion suggests that the statute should be construed to include the modern valuation techniques utilized by the financial community and exclude only those elements of post-merger value that are purely speculative in nature.[85]

Commentators have observed that the *Weinberger* interpretation of the Delaware appraisal statute would permit employment of a third-party sale value standard to evaluate frozen-out shares.[86] It is suggested that Professor Weiss has correctly maintained that a third-party sale value should be the standard utilized by courts

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[80] *See Weinberger*, 457 A.2d at 713-14; DEL. CODE ANN. tit. 8, § 262(h) (Supp. 1982); N.Y. BUS. CORP. L. § 623(h)(4) (McKinney Supp. 1982). Delaware's prior appraisal statute simply provided that "[t]he Court [should] . . . determine the value of the stock." DEL. CODE ANN. tit. 8, § 262(f) (1974).

[81] N.Y. BUS. CORP. LAW § 623(h)(4) (McKinney Supp. 1982).

[82] Ch. 202, § 1, [1982] N.Y. Laws 621 (McKinney). The New York Legislature declared:

> The case law interpretation of fair value has not always reflected the reality of corporate business combinations. These transactions involve the sale of the corporation as a whole, and the corporation's value as an entirety may be substantially in excess of the actual or hypothetical market price for shares trading among investors. Thus, experience has demonstrated that large premiums over market price are commonplace in mergers and in asset acquisitions.

Id.

[83] DEL. CODE ANN. tit. 8, § 262(h) (Supp. 1982).

[84] *See* Borden, *supra* note 37, at 29, col. 1.

[85] *See* 457 A.2d at 714.

[86] *See* Weiss, *supra* note 50, at 251-52; Chazen, *supra* note 31, at 19, col. 4. *Weinberger* suggests that the parent corporation has a fiduciary obligation to disclose to the subsidiary and its minority shareholders the highest price the parent is willing to pay for the acquisition of the minority's shares. *See* 457 A.2d at 709. This obligation to disclose, it is submitted, may have the *practical effect* of inducing the parent corporation to offer its subsidiary the highest price it is willing to pay to eliminate the minority, since few minority shareholders would vote for a merger when the parent company offers less than it has admitted it is willing to pay.

to establish the *minimum* cash-out price.[87] Although it may be argued that the use of a third-party sale value "go[es] well beyond . . . giving the minority the protection it would have in an acquisition negotiated at arm's length,"[88] Professor Weiss notes that the majority's fiduciary duty both to the parent's shareholders and to the subsidiary's minority shareholders dictates the use of such an appraisal value, "for if the subsidiary is worth more to a third party than it is to the parent company, presumably [all] shareholders would benefit if the subsidiary were sold."[89]

In addition to interpreting the Delaware appraisal statute as permitting any valuation method utilized by the financial community, the *Weinberger* court determined that the "all relevant factors" language of the statute was designed to "[include] any damages, resulting from the taking, which the stockholders sustain as a class."[90] This broad language may be construed as authorizing Delaware courts to grant dissenting shareholders "compensation for cancelled stock options, incurred tax liability, and loss of the ownership right which under normal circumstances entitles a stockholder to buy or sell according to hiw [sic] own whim."[91] Awarding such damages in an appraisal proceeding would ameliorate the adverse effects created by the "forced sale" of the frozen-out shares and would, in essence, protect any shareholder interest in the form

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[87] *See* Weiss, *supra* note 50, at 251. Professor Weiss has suggested that a third-party sale standard would inhibit only those freezeouts that are designed to exploit minority shareholders and would not prevent the consummation of mergers transacted to achieve economies of size. *Id.*

[88] Chazen, *supra* note 31, at 19, col. 4. It has been observed that third-party acquisitions yield a higher premium over market than similar acquisitions by a parent-majority shareholder since the third party must pay for the control shares. *Id.* Thus, it can be argued that a third-party sale value standard in freezeout mergers unjustly would require the parent corporation to pay a control premium for shares in a corporation it already controls. *Id.*

[89] Weiss, *supra* note 50, at 251-53.

[90] 457 A.2d at 713.

[91] Klimpl, Stein & Hayworth, *supra* note 58, at 38, col. 1. It is submitted that the New York appraisal statute, containing language similar to that of its Delaware counterpart, also could be interpreted to permit dissenting shareholders to recover for canceled stock options, incurred tax liability, and the loss of ownership rights. The New York appraisal statute provides, in pertinent part:

> In fixing the fair value of the shares, the court shall consider the nature of the transaction giving rise to the shareholder's right to receive payment for shares and its effects on the corporation and its shareholders, the concepts and methods then customary in the relevant securities and financial markets for determining fair value of shares of a corporation engaging in a similar transaction under comparable circumstances and *all other relevant factors.*

N.Y. BUS. CORP. L. § 623(h)(4) (McKinney Supp. 1982-1983) (emphasis added).

of his investment without impeding the consummation of a potentially value-enhancing merger.[92]

CONCLUSION

Weinberger is both a summary and a clarification of the protection that Delaware law affords a shareholder whose equity participation in a corporation has been frozen out by the consummation of a merger. First, a merger may not be challenged by dissenting shareholders on the ground that the transaction lacked a valid business purpose. Second, shareholders dissatisfied with the share price offered by the parent corporation will be relegated to an appraisal proceeding, with equitable intervention available only upon a showing of unfair dealing. This restriction on equitable relief, it is suggested, adequately promotes the state's interest in minority shareholder protection without unnecessarily impeding corporate flexibility and development. The appraisal proceeding, moreover, largely has been reformed, permitting Delaware courts to consider not only market value, earnings, and assets, but *all factors* relevant to a determination of share value. It is suggested that the price a third party would offer for the purchase of the dissenting shares be adopted in appraisal proceedings as the minimum value of the shares. Such a standard, taken as the ground of share evaluation, would aid in offsetting the superior bargaining position enjoyed by the controlling shareholders and would ensure adequate consideration for the minority's shares.

Donna M. Morello

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[92] *See supra* notes 41-50 and accompanying text.